UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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Stillwater Liquidating LLC,

Plaintiff-Appellant,

-against-

Net Five at Palm Pointe, LLC; Net Five Holdings LLC; Planet Five Development Group LLC; Net Five South Beach LLC; Net Five at Kings Hotel LLC; Net Five at Hallandale LLC; Boggy Creek Villas, LLC; Net Five East Lyme, LLC; Net Five-FDA at Islamorada, LLC; 1888 Boggy Creek Road, LLC; Planet Five at Gerova LLC; Paul Rohan; Eric Halter; Paradigm Credit Corp.; Saunders Capital LLC; Calhoun Commercial Construction LLC; Judge Street Realty LLC; SFN Dekalb Holdings LLC; Memphis Blues Acquisition Group, LLC; Shreeji Hospitality of Charlotte, LLC; Redrock Kings, LLC; John R. Daniel, III; Yvette Daniel; Stephen J. McDonald; Vicki McDonald; CL RP Stonecrest LLC; 335 Washington Avenue ï Miami Beach LLC; 347 Washington Avenue ï Miami Beach LLC; and Alma Bank,

Defendant-Appellees.

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No. 16 Civ. 08883

(Hon. Edgardo Ramos)

Bankruptcy Case No. 12-14140 (MEW)

Adv. Proc. No. 14-02245 (MEW)

BRIEF OF DEFENDANT-APPELLEE PARADIGM CREDIT CORP.

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PRELIMINARY STATEMENT

Notwithstanding being granted two opportunities to amend its complaint to cure obvious deficiencies, the lower court dismissed all claims asserted by plaintiff-appellant Stillwater Liquidating LLC (ñPlaintiffò) against, among others, defendant-appellee Paradigm Credit Corp. (ñParadigmò). Plaintiff now appeals that decision. For the reasons discussed below, the lower courtôs decision should be affirmed.

This appeal centers on one discrete issue ï that the transfers sought to be avoided involve non-debtor Stillwater Asset Backed Fund, LP (the ñDelaware Fundò), *not* Stillwater Asset Backed Offshore Fund Ltd. (the ñDebtorò), the only entity that was a chapter 11 debtor. The principal brief of Plaintiff (ñAppellant Briefò) attempts to cloud this issue, but, at bottom, this adversary proceeding is an attempt by Plaintiff to assert fraudulent conveyance claims of creditors of the Delaware Fund (and its non-debtor subsidiaries), *not* of the Debtor. Plaintiff cannot assert such claims. This issue permeates all of Plaintiffôs arguments, which necessarily fail.

Plaintiffôs claims against Paradigm involve two separate loans made by Paradigm that have since been repaid. The First Paradigm Loan (defined below) was secured by a separate mortgage loan (the ñKings Hotel Loanò). That

underlying mortgage loan that served as collateral was made initially by the Delaware Fund to a third party borrower, which granted the Delaware Fund a mortgage on its real property. Paradigm held a security interest in the loan and mortgage, not the real property itself. The Second Paradigm Loan (defined below) was secured by a mortgage on real property owned originally by a subsidiary of the Delaware Fund (the ñSt. Augustine Propertyò). The Delaware Fundôs subsidiary obtained the property free and clear in an unrelated bankruptcy sale. The Second Paradigm Loan proceeds were used by a borrower to purchase the St. Augustine Property from the Delaware Fundôs subsidiary.

Section 544 (ñSection 544ò) of title 11 of the United States Code (the ñBankruptcy Codeò), the provision relied on by Plaintiff to assert its fraudulent conveyance claims, permits a trustee to assert *only* claims of a creditor of a *debtor* based on the *debtor's* pre-petition transfer of property. Here, there is no transfer of a debtorôs property and, at most, Plaintiff was the assignee of claims of non-debtors (*e.g.*, the Delaware Fund). Section 544 does not allow Plaintiff to assert claims of a non-debtorôs creditors, regardless of whether Plaintiff has the contractual right to prosecute claims on the non-debtorôs behalf. Each of Plaintiffôs arguments sought an end run around this result (*e.g.,* that there was substantive consolidation of the Delaware Fund and the Debtor or that they were

alter egos). (Appellant Brief, pp. 13-16.) Each was rejected properly by the lower court.

Plaintiff attempts to use the Debtorôs participation interest in several of the Delaware Fundôs loans to create a Section 544 right. (Appellant Brief, pp. 16-21.) However, the participation agreements did not give the Debtor an ownership interest in the Delaware Fundôs assets that were used as collateral for Paradigmôs loans at the time the loans were made. If anything, the Debtor may have had a beneficial interest in a loan, which does not confer standing to assert claims against transferees. Moreover, with respect to one of the Paradigm loans, the Delaware Fund was never the owner of the underlying loan at issue *and* that loan was extinguished prior to the Delaware Fundôs entry into the applicable participation agreement, thus, there was no participation in that loan.

Plaintiff goes to great lengths to argue that the Delaware Fundôs assets were looted as part of the so-called Gerova Transfer, the alleged transfer by the *Funds* to *Gerova.*[1] Plaintiff believes the so-called ñGerova Transferò tainted all future transfers, including transfers to Net Five Holdings LLC (ñNFHò) or its affiliates,

[1] Plaintiff uses the vague definition of *Gerova* throughout this proceeding. For example, Plaintiff first defined ñGerovaò to include Gerova Financial Group, Ltd. (ñGFGò) and Gerova Holdings Ltd. (A. 1918, ¶ 1), but now defines Gerova loosely as ñGerova Financial Groupò (presumably, GFG) and its affiliates and subsidiaries (Appellant Brief, p. 1).

and relies on conclusory statements in the First Amended Complaint (the ñFACò) on this point. However, the record is clear that the Delaware Fund and its subsidiary, which were, at least at one point, the owners of the collateral secured by Paradigmôs loans, were not part of this alleged asset transfer to Gerova. Instead, the Delaware Fund was the surviving entity upon its merger with both Stillwater Asset Backed Fund II, LP (ñSABF IIò) and Gerova AB Fund Mergerco LP (ñGerova ABò). As the surviving entity, the Delaware Fund could not have been left an empty shell after the merger (as alleged by Plaintiff) ï it retained its ownership of its assets, including its ownership in any of its subsidiaries.

Further, even if Plaintiff did have standing to attack transfers to Paradigm, Plaintiff does not articulate what *transfers* it seeks to avoid. Here, Paradigmôs loans were repaid and the related security interests released. In addition, many of the alleged ñred flagsò that Plaintiff contends put parties on notice of fraud occurred subsequent to the funding of Paradigmôs loans. Plaintiff also fails to meet its burden of showing a lack of good faith.

Plaintiff asserts common law claims against Paradigm for conspiracy to defraud and convert, and for aiding and abetting conversion and breach of fiduciary duty. (A. 2028-30, 2032-33.) Each of these claims is based on Plaintiffôs conclusory allegations that Paradigm provided funding to ñgreaseò the alleged

scheme to strip the Fundsô assets and remove them from the reach of the Fundsô creditors. (A. 2029-33, ¶¶ 463, 468, 484.) Each of these claims requires allegations that Paradigm had *actual* knowledge of the scheme. Plaintiff failed woefully to allege *actual* knowledge ï *i.e.*, its allegations are either conclusory or do not plausibly suggest Paradigm had actual knowledge. For example, Plaintiff alleges repeatedly that Paradigm should have known of the scheme because of ñred flagsò ï an allegation that seeks to show constructive knowledge, not actual knowledge ï and those allegations even fail to show constructive knowledge. Plaintiff also does not allege that Paradigm knew of any involvement by NFH or any of its affiliated entities. Dismissal of these common law claims should, therefore, be affirmed.

Lastly, the lower court dismissed correctly Plaintiffôs claims for unjust enrichment and constructive trust.

FACTUAL BACKGROUND[2]

A. The First Paradigm Loan (Secured by the Kings Hotel Loan)

On March 22, 2006, the Delaware Fund made the Kings Hotel Loan to Kings Hotel, Inc. (ñKHIò) and, as security for the Kings Hotel Loan, KHI granted

[2] For the sake of brevity, only relevant facts are repeated here. Unless otherwise noted, all of the facts below are as alleged by Plaintiff in the FAC.

the Delaware Fund a mortgage (the ñKings Hotel Mortgageò) on certain property in Brooklyn, New York (the ñKings Hotel Propertyò). (A. 1988, ¶ 266.)

The Delaware Fund and the Debtor entered into master loan participation agreements (collectively, the ñMLPAò) with respect to certain loans pursuant to which the Debtor allegedly purchased a participation interest in such loans. (A. 1988, ¶ 267.) The MLPA allegedly with respect to the Kings Hotel Loan was dated January 1, 2008.[3] (A. 1988, ¶ 267.)

In the FAC, Plaintiff alleges incorrectly that on January 20, 2010, the Kings Hotel Mortgage and the Debtorôs participation interest was transferred to Gerova[4] ñand/or converted by Gerova pursuant to the Gerova Transfer.ò (A. 1989, ¶ 269.)

By assignment dated June 23, 2010, and recorded on June 29, 2010, the *Delaware Fund* transferred the Kings Hotel Mortgage to NFH. (A. 2255; Decision, p. 69.) Plaintiff alleges in the FAC that the transfer took place on May 26, 2010, but that Gerova transferred it to NFH pursuant to an operating agreement. (A. 1989, ¶ 270.)

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[3] Each of the MLPAs filed by Plaintiff with the lower court are substantially similar, only one of which was included in the Appendix (A. 1297-1310). The MLPA allegedly with respect to the Kings Hotel Loan can be found at 131-11 on the lower courtôs docket.

[4] The FAC does not refer to which Gerova entity was the transferee.

In July 2010, the Kings Hotel Loan and the Kings Hotel Mortgage were assigned to Sawtooth Capital, LLC (ñSawtoothò) to secure a $500,000 loan. (A. 1989, ¶ 271.) Later that month, the Kings Hotel Loan and the Kings Hotel Mortgage were assigned back to NFH. (A. 1989, ¶ 271.)

On August 4, 2010, NFH assigned the Kings Hotel Loan and the Kings Hotel Mortgage to Net Five at Kings Hotel, LLC, a New York limited liability company (ñNFKHò). (A. 1989, ¶ 271.)

On August 5, 2010, Paradigm made a $3,300,000 loan (the ñFirst Paradigm Loanò) to NFKH and, as security for the First Paradigm Loan, NFKH granted Paradigm, among other things, a *security interest* in the Kings Hotel Loan and the Kings Hotel Mortgage. (A. 1989, ¶ 271.)

Approximately one year later, in August 2011, the First Paradigm Loan was repaid. (A. 1992, ¶¶ 281-82.)

B. The Second Paradigm Loan (Secured by the St. Augustine Property)

In November 2005, St. Augustine Hotel, LLC (ñSAHò) purchased the St. Augustine Property (property located in Miami Beach, Florida) with funds from a loan (the ñJPS-AUG Loanò) made by AUG Funding, LLC (ñAUGò). (A. 1969, ¶¶

176-77.) As security for the JPS-AUG Loan, AUG was granted a first mortgage on the St. Augustine Property. (A. 1969, ¶ 177.)

AUG is a subsidiary of JPS Loan Holdings I, LLC (ñJPSò). (A. 1969, ¶ 176.) JPS is a subsidiary of the Delaware Fund. (A. 1969, ¶ 176.)

The Delaware Fund and the Debtor entered into a MLPA with respect to the JPS-AUG Loan. (A. 1970, ¶¶ 180-82.) The MLPA allegedly with respect to the JPS-AUG Loan was dated July 1, 2009. (A. 1297.)

SAH defaulted on the JPS-AUG Loan and commenced a chapter 11 case, and, in May 2007, AUG obtained title to the St. Augustine Property at a bankruptcy sale in SAHôs chapter 11 case pursuant to section 363 of the Bankruptcy Code (the ñSection 363 Saleò).[5] (A. 1969, ¶ 178.)

On May 7, 2008, AUG borrowed funds from Stonegate Bank, secured by the St. Augustine Property, and Stonegate Bank later assigned the loan to EWE Loan No. 4 LLC (ñEWEò). (A. 1969-70, ¶¶ 179, 184-85.)

[5] The JPS-AUG Loan was extinguished as part of the Section 363 Sale; however, Plaintiff alleges that on July 1, 2009 (more than two years later), it took a participation interest in that loan. The Lower Court discusses this discrepancy at length. (A. 2257-58; Decision, pp. 71-72.) A copy of the sale order in SAHôs chapter 11 case relied on by the Lower Court can be found at 189-45 on the lower courtôs docket.

In the FAC, Plaintiff alleges incorrectly[6] that (a) on January 20, 2010, the St. Augustine Property and the Debtorôs participation interest was transferred to Gerova ñand/or converted by Gerova pursuant to the Gerova Transferò (A. 1970, ¶ 182), and (b) on May 26, 2010, the St. Augustine Property and the Debtorôs participation interest was assigned to NFH pursuant to an operating agreement (A. 1970, ¶ 183).

On December 20, 2011, AUG sold the St. Augustine Property to Net Five at South Beach, LLC, a Florida limited liability company (ñNFSBò). (A. 1971, ¶ 188.) That same day, NFSB borrowed $2,700,000 from Paradigm (the ñSecond Paradigm Loanò) and, as security for the loan, NFSB granted Paradigm, among other things, a mortgage on the St. Augustine Property. (A. 1971, ¶ 190.)

The Second Paradigm Loan was repaid in March 2013. (A. 1972, ¶¶ 194, 198.)

PROCEDURAL HISTORY

On January 17, 2013, the United States Bankruptcy Court for the Southern District of New York (the ñBankruptcy Courtò or the ñLower Courtò) entered an

[6] These allegations are contradicted by allegations in the following paragraph ï that the St. Augustine Property was sold by AUG.

order for relief in the Debtorôs chapter 11 case, which was filed on October 3, 2012, under Case No. 12-14140.[7] (A. 1927, ¶ 20, 1953, ¶ 125.)

On October 2, 2014, Plaintiff commenced this adversary proceeding in the Bankruptcy Court by filing its complaint (the ñOriginal Complaintò). (A. 215-95.) On March 30, 2015, Paradigm (and other defendants in the action) moved to dismiss Plaintiffôs claims. (A. 443, 644, 651, 658-682, 686, 690, 697, 703, 709, 1139-45.)

On May 15, 2015, at the Bankruptcy Courtôs request and while the motions to dismiss were pending, Plaintiff filed an extensive supplement to the Original Complaint (the ñSupplementò). (A. 781-814.)

Almost a year later, on April 22, 2016, Plaintiff filed the FAC after moving the Bankruptcy Court for permission to do so. (A. 1917-2040.) Through the FAC, Plaintiff asserts 16 separate causes of action against the defendants. (A. 2017-38.) However, the FAC includes only the following claims against Paradigm: (i) Recovery of Subsequent Transfers under 11 U.S.C. § 544(b) and N.Y. D.C.L. §§ 278, 279 (Count V); (ii) Conspiracy to Defraud and Convert Property (Count VIII); (iii) Aiding and Abetting Conversion (Count IX); (iv) Aiding and Abetting Breach

[7] On August 24, 2012, GFG and Gerova Holdings Ltd. commenced a chapter 15 case in the Bankruptcy Court. (A. 1928, ¶ 24.)

of Fiduciary Duty (Count XI); (v) Unjust Enrichment (Count XIV); (vi) Constructive Trust (Count XV); and (vii) Accounting (Count XVI).

On September 2, 2016, notwithstanding Plaintiffôs three attempts to assert valid claims against Paradigm (*i.e.,* the Original Complaint, the Supplement, and the FAC), the Bankruptcy Court dismissed the FAC as against Paradigm and certain other defendants (the ñDecisionò). (A. 2187-292.) On October 26, 2016, the Bankruptcy Court entered an Order dismissing Plaintiffôs claims (the ñOrderò). (A. 3896-3901.) That same day, judgment was entered (the ñJudgmentò). (A. 3902-03.)

LEGAL STANDARDS

A. Appeal Standard

In reviewing a bankruptcy court judgment as an appellate court, the district court reviews the bankruptcy courtôs (a) findings of fact under a clearly erroneous standard and (b) conclusions of law *de novo*. *See, e.g., In re Quigley Co., Inc.,* 449 B.R. 196, 200-01 (S.D.N.Y. 2011); *In re Ames Dep't Stores, Inc.*, 582 F.3d 422, 426 (2d Cir. 2009) (ña finding is óclearly erroneousô when [the reviewing court] is left with the definite and firm conviction that a mistake has been madeò).

B. Pleading Standard on Motions to Dismiss

To survive a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure, made applicable to this proceeding by Rule 7012 of the Federal Rules of Bankruptcy Procedure (the ñBankruptcy Rulesò), the plaintiff must plead enough facts ñto óstate a claim to relief that is plausible on its face.ôò *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 [2007]). A court must accept all well-pleaded facts as true and must draw all reasonable inferences in favor of the plaintiff, but the court is not bound to accept as true legal conclusions couched as factual allegations. *See Iqbal*, 556 U.S. at 678. ñNor does a complaint suffice if it tenders ónaked assertion[s]ô devoid of ófurther factual enhancement.ôò *Iqbal*, 556 U.S. at 663 (quoting *Twombly*, 550 U.S. at 557). If there are insufficient factual allegations to raise a right to relief above the speculative level, the complaint must be dismissed. *See Twombly*, 550 U.S. at 555. As the Lower Court concluded, Plaintiff fails to meet this standard.

ARGUMENT

POINT I

PLAINTIFF DOES NOT HAVE STANDING TO ASSERT CLAIMS AGAINST PARADIGM UNDER SECTION 544 AS AN ASSIGNEE OF THE DELAWARE FUND OR OTHERWISE

Paradigm hereby incorporates by reference and requests that this Court consider the argument set forth by defendant-appellees John R. Daniel, III, Yvette

Daniel, Stephen J. McDonald, and Vicki McDonald (collectively, the ñDaniels and McDonaldsò) in Point I of their brief in response to the Appellant Brief, dated February 17, 2017 (the ñDaniels/McDonalds Briefò).[8]

Further, to the extent Paradigm was granted a security interest in collateral related to a direct or indirect subsidiary of the Delaware Fund (*e.g.*, AUG), it does not change the analysis as neither the Delaware Fund or its subsidiaries were debtors. Therefore, Section 544 is unavailable and Plaintiff has no standing.

The bottom line is Section 544 does not permit a trustee (or Plaintiff) to assert claims of a non-debtorôs creditors.[9] *See, e.g., Official Comm. of Asbestos Claimants of G-I Holding, Inc. v. Heyman*, 277 B.R. 20, 29 (S.D.N.Y. 2002) (under Section 544, a ñtrustee succeeds to the rights of an allowed unsecured creditor [of the debtor] in existence at the commencement of the case who can avoid the transfer or obligation under applicable state or local lawò).

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[8] Paradigm seeks to join in these arguments as Paradigm and the Daniels and McDonalds are represented by the same attorneys in this proceeding. It should be noted, however, that besides being represented by the same attorneys, there is no other affiliation or relationship between Paradigm and the Daniels and McDonalds.

[9] To the extent Plaintiff believes it has separate claims under the New York Debtor and Creditor Law (ñNYDCLò) absent Section 544, it is wrong. The Bankruptcy Court does not have jurisdiction to entertain these claims under the NYDCL without application of Section 544. *See, e.g., In re General Media, Inc.*, 335 B.R. 66, 75 (Bankr. S.D.N.Y. 2005) (court did not have jurisdiction to hear a post-confirmation non-debtor dispute simply because it might conceivably increase the recovery to creditors).

POINT II

THE PARTICIPATION AGREEMENTS DO NOT GIVE THE DEBTOR AN INTEREST IN THE DELAWARE FUNDSô ASSETS, NOR ANY OF ITS SUBSIDIARIESô ASSETS

Paradigm hereby incorporates by reference and requests that this Court consider the argument set forth by the Daniels and McDonalds in Point II of the Daniels/McDonalds Brief. (The MLPA quoted in the Daniels/McDonalds Brief is the alleged MLPA related to the JPS-AUG Loan [A. 1297-1310] as it was the MLPA included in the Appendix. All of the MLPAs at issue are substantially similar.)

Further, the Debtor acquired no interest at all with respect to the JPS-AUG Loan. First, the MPLA related to the JPS-AUG Loan was between the Debtor and the Delaware Fund. AUG (the entity that owned the JPS-AUG Loan and purchased the St. Augustine Property at the Section 363 Sale) was *not a party* to it. The Delaware Fund could not sell a participation interest in a loan it did not own. Second, the MLPA allegedly with respect to the JPS-AUG Loan was dated July 1, 2009 (A. 1297), however, the JPS-AUG Loan was extinguished in May 2007, more than two years earlier, when AUG obtained title to the St. Augustine Property at the Section 363 Sale. (A. 1969, ¶ 178; A. 2257-58.)

In sum, for the reasons set forth above and in the Daniels/McDonalds Brief, the MLPA does not give Plaintiff standing to assert claims based on any transfer by the Delaware Fund or any of its subsidiaries, including any transfer of the Kings Hotel Loan, the Kings Hotel Mortgage, or the St. Augustine Property.

POINT III

THE SO-CALLED GEROVA TRANSFER WAS IRRELEVANT TO THE CLAIMS AGAINST PARADIGM

Paradigm hereby incorporates by reference and requests that this Court consider the argument set forth by the Daniels and McDonalds in Point III of the Daniels/McDonalds Brief.

Further, Plaintiff in the FAC contradicts itself in discussing the so-called Gerova Transfer. For example, in the FAC, Plaintiff alleges that in 2010, the St. Augustine Property was transferred to Gerova as part of the so-called Gerova Transfer and then it was transferred to NFH pursuant to an operating agreement (A. 1970, ¶¶ 182-83). However, Plaintiff also alleges that AUG[10] sold the St. Augustine Property to NFSB on December 20, 2011. (A. 1971, ¶ 188.) These two allegations cannot both be true.

[10] Plaintiff refers to a prior AUG chapter 11 case (the ñAUG Bankruptcyò) that was dismissed, upon a motion by EWE, however, Plaintiff points to nothing related to that bankruptcy case that had an effect on the ownership of the St. Augustine Property. (A. 1970-71, ¶¶ 185-87.)

Also, in the FAC, Plaintiff alleges that the Delaware Fund transferred the Kings Hotel Mortgage to Gerova as part of the Gerova Transfer and then it was transferred to NFH on May 26, 2010, pursuant to an operating agreement. (A. 1989, ¶¶ 269-70.) However, pursuant to the assignment dated June 23, 2010, and recorded on June 29, 2010, the Delaware Fund transferred the Kings Hotel Mortgage to NFH. (A. 2255; Decision, p. 69.) Again, Plaintiffôs allegations are inconsistent.

As discussed in the Daniels/McDonalds Brief, the FAC fails to allege any facts that show that the Delaware Fund was stripped of its assets (which include its ownership of the Kings Hotel Loan and the Kings Hotel Mortgage, and its interest in AUG, which owned the St. Augustine Property). At the time Paradigm made its loans, the Delaware Fundôs assignee or its subsidiary was the owner of the collateral, in which Paradigm received a security interest. Therefore, Plaintiff cannot use the so-called Gerova Transfer to confer standing on itself to attack the loans made by Paradigm.

POINT IV

PLAINTIFF HAS NO CLAIM AGAINST PARADIGM FOR TRANSFERS TO IT AS A SUBSEQUENT TRANSFEREE

Even if the Plaintiff did have standing to attack transfers to Paradigm (which it did not, as discussed above and set forth in the Decision), it also failed to plead a fraudulent transfer claim as against Paradigm.

First, Plaintiff fails to allege the specific transfers to Paradigm it seeks to avoid as fraudulent transfers. As the Lower Court ruled, Paradigm was not a transferee of any of the Fundsô property. Plaintiff did not allege that Paradigm foreclosed on the Kings Hotel Loan or the St. Augustine Property (which would have given Paradigm ownership of the collateral) ï it had only a lien on each, for a short period of time, while its loans were outstanding. (A. 2256-57; Decision, pp. 70-71.) To the extent the transfers to Paradigm of security interests in collateral were the transfers Plaintiff seeks to avoid, those transfers were returned to the original transferors and Plaintiff has not alleged that they were not ï *i.e.,* when Paradigm was repaid, it released its security interest on the collateral. Plaintiff has not explained how Paradigm making a loan and being repaid constitutes a fraudulent transfer. The bottom line is that Paradigm is not a subsequent transferee of any property. It held only a temporary lien on collateral that never resulted in it being the transferee of that collateral.

Second, many of the ñred flagsò referred to by Plaintiff in the FAC relate to conduct that took place *after* Paradigm made the loans. For example, Plaintiff makes allegations concerning: (a) the articles discussing Gerova and Stillwater that were published in 2011 (A. 1954-56, ¶¶ 132-36), (b) the Dalrymple report that came out on January 10, 2011 (A. 1956-57, ¶¶ 137-38), (c) the class action lawsuits, the earliest of which was commenced in March 2011 (A. 1957-59, ¶¶ 139-45), and (d) the Net Five injunction that was issued on July 12, 2012 (A. 1959, ¶ 146). But Paradigm made the First Paradigm Loan on August 5, 2010, well before *any* of these events. Paradigm could not have known of these alleged ñred flags.ò

Lastly, to sustain its pleading burden, Plaintiff was required to plead at least some facts sufficient to show Paradigm acted without ñgood faithò with respect to the transfers. *See, e.g., S.I.P.C. v. Bernard L. Madoff Inv. Sec. LLC*, 516 B.R. 18, 24 (S.D.N.Y. 2014) (this Court ruled that a defendant may succeed on a motion to dismiss by showing that the complaint does not plausibly allege that that defendant did not act in good faith). In *Madoff,* this Court noted that the plaintiff had ñextensive discovery powersò under Rule 2004 of the Bankruptcy Rules ñthrough which he may gather information before he ever files a complaint,ò and stated that ñ[i]t is thus not unreasonable to require that the [plaintiff] provide a plausible basis to claim that a defendant lacked good faith in his initial complaint.ò 516 B.R. at

24, n.5. Here, Plaintiff did not plausibly allege that Paradigm lacked good faith. For example, Paradigm made loans to NFSB and NFKH for a total of $6 million dollars, taking the risk of a default and that its security would not cover the amounts due. However, Plaintiff makes conclusory statements only as to Paradigmôs alleged lack of good faith ï that these loans somehow helped a scheme that Paradigm should have known about because of ñred flags.ò That is not plausible.

POINT V

PLAINTIFFôS COMMON LAW CLAIMS FOR CONSPIRACY AND AIDING AND ABETTING FAIL AS AGAINST PARADIGM

Plaintiff asserts claims against Paradigm for (a) conspiracy to defraud and convert property, (b) aiding and abetting conversion, and (c) aiding and abetting breach of fiduciary duty. The Lower Court correctly dismissed these conspiracy and aiding and abetting claims.

A. Plaintiff Fails to Allege Actual Knowledge

Conspiracy and aiding and abetting claims require that the defendant had *actual* knowledge of the underlying tort. *See, e.g., Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC,* 652 F. Supp. 2d 495, 502 (S.D.N.Y. 2009) (ñ[u]nder New York law, a defendant must be shown to possess actual knowledge of the underlying fraudò); *Chemtex, LLC v. St. Anthony Enters.,*

Inc., 490 F. Supp. 2d 536, 546 (S.D.N.Y. 2007) (ñNew York courts, however, have uniformly required that a defendant have actual knowledge of the alleged fraud to sustain a claim for aiding and abettingò); *Filler v. Hanvit Bank*, 339 F. Supp. 2d 553, 557 (S.D.N.Y. 2004), *aff'd*, 156 F. Appôx 413 (2d Cir. 2005) (ñthe complaint must allege facts which show that the defendant had actual knowledge of the underlying fraudò); *Kashi v. Gratsos*, 790 F.2d 1050, 1055 (2d Cir. 1986) (conspiracy requires knowledge and ñintentional participation in the furtherance of the plan or purposeò); *Kolbeck v. LIT Am., Inc.*, 939 F. Supp. 240, 246 (S.D.N.Y. 1996) (actual knowledge is required for aiding and abetting breach of fiduciary duty); *JP Morgan Chase Bank v. Winnick*, 406 F. Supp. 2d 247, 253 (S.D.N.Y. 2005) (actual knowledge required for aiding and abetting and conspiracy claims).

Allegations of constructive knowledge, recklessness, or willful blindness as to whether the primary actor is engaged in fraud are not sufficient to satisfy the knowledge element of these claims. *See, e.g., Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 446 F. Supp. 2d 163, 202, n.279 (S.D.N.Y. 2006) (ñthe overwhelming weight of authority holds that actual knowledge is required, rather than a lower standard such as recklessness or willful blindnessò); *Chemtex,* 490 F. Supp. 2d at 546 (allegations of constructive knowledge are not enough); *Rosner v. Bank of China*, 2008 WL 5416380, at *7 (S.D.N.Y. Dec. 18, 2008), *aff'd*, 349 F. Appôx 637 (2d Cir. 2009) (ñwillful

blindnessò does not satisfy the knowledge requirement); *Kolbeck*, 939 F. Supp. at 246 (ñNew York common law, which controls the analysis here, has not adopted a constructive knowledge standard for imposing aiding and abetting liabilityò).

As the Lower Court determined, Plaintiff fails to allege plausibly that Paradigm had actual knowledge and the dismissal of the common law claims should be affirmed.

B. The So-Called Red Flags

In an attempt to revive its claims, Plaintiff focuses in the FAC and the Appellate Brief on what it calls ñred flagsò ï information that Paradigm should have known and led it to discover the alleged fraud ï to show that it has met its pleading requirement with respect to the element of knowledge. However, the nature of a ñred flagò is linked to the determination as to whether there is constructive knowledge, *not* actual knowledge. In *Rosner* (relied on by the Lower Court), the Second Circuit held that statements alleging that a defendant ñshould have known,ò along with ñconclusory statementsò that the defendant ñactually knewò are insufficient. *See Rosner*, 349 F. Appôx. at 639. This is exactly what Plaintiff does in the FAC. For example, Plaintiff alleges in the FAC that (a) the lenders ñdid not perform adequate due diligenceò (A. 1966, ¶ 160), (b) the lenders ñturned a blind eye to what they found, forging ahead with liens, despite information that should have at the very least prompted further inquiryò (A. 1966,

¶ 161), (c) ñthis should have raised another red flag for Paradigmôs principals as to why Gerova was providing a guaranty to Paradigmò (A. 1991, ¶ 276), (d) ñthere were irregularities in the conduct of Gerova which, had Paradigm done due diligence, would or should have put it on notice of the [s]chemeò (A. 1991, ¶ 277), and (e) facts ñshould have led Paradigm to question ASSACôs role and why still further layers of entities were interposed in documenting Paradigmôs loanò (A. 1992, ¶ 280). The Appellant Brief carries on this constructive knowledge argument. For example, Plaintiff states that ñ[the lender] failed to do due diligence, or if they did any, turned a blind eye to its findings.ò (Appellant Brief, p. 43.) However, at no point does Plaintiff allege plausibly that Paradigm had actual knowledge.[11]

Moreover, as concluded by the Lower Court, these allegations are not sufficient to support even an allegation of constructive knowledge. (A. 2272-73, 2275, 2279; Decision, pp. 86-87, 89, 93.) The Lower Court broke down the allegations in the FAC into three groups ï those related to Gerova, those that relate to the First Paradigm Loan, and those that relate to the Second Paradigm Loan. The Lower Court analyzed each of the allegations, showing how the allegations

[11] Plaintiff argues in the Appellant Brief that circumstantial evidence is enough to show knowledge. (Appellant Brief, p. 42.) However, Plaintiff still fails to show that any circumstantial evidence demonstrates actual knowledge. Moreover, none of the allegations referred to by Plaintiff related to circumstantial evidence address Paradigmôs alleged actual knowledge. (Appellant Brief, p. 42-44.)

fail to rise to the level of neither actual knowledge nor constructive knowledge. (A. 2270-79; Decision, pp. 84-93.) For example, the allegations with respect to Gerova do not suggest that Paradigm had any knowledge with respect to NFHôs conduct. Plaintiff also focuses on some of the underlying loan documents ï *e.g.,* that it was suspicious that Gerova guaranteed the First Paradigm Loan (A. 1991, ¶ 275) ï but Plaintiff fails to allege how any of the transaction documents show any implication of fraud. Plaintiff continues to rely on allegations that ñthis should have raised another red flag.ò (A. 1991, ¶ 276.) The Lower Court ruled that such conclusions were not enough to sustain a claim. For these reasons, the same result is warranted here.[12]

Further, as discussed in Point IV above, many of Plaintiffôs allegations could not have been known by Paradigm at the time it made the loans (especially, with respect to the First Paradigm Loan). Each of Plaintiffôs allegations with respect to the articles discussing Gerova and Stillwater, the Dalrymple report, the class action lawsuits, and the injunction, all took place after the closing of the First Paradigm Loan. (A. 1954-59, ¶¶ 132-46.)

[12] Plaintiff contends that the Lower Court ñincorrectly concluded that nothing shows that the AUG Bankruptcy was dismissed because of fraud.ò (Appellant Brief, p. 43.) However, in response, Plaintiff claims that ñit was dismissed because it was brought in bad faith and as an effort to evade AUGôs lender, which amounts to fraud.ò (Appellant Brief, p. 43.) Plaintiff offers no legal or factual support for this conclusory statement. This is another example of Plaintiffôs allegations failing to rise to even the level of constructive knowledge.

C. Allegations as to the Scheme

Realizing that it has no allegations in the FAC as to Paradigmôs involvement in the alleged scheme, Plaintiff argues that Paradigmôs loans supported the alleged scheme. (Appellant Brief, p. 42.) This statement is conclusory and should be ignored. Further, Plaintiff does not explain how Paradigmôs loans actually aided the scheme. For example, Plaintiff states that Paradigm ñenabled Net Five and Rohan to borrow against equity in the Fundsô Real Property Interests.ò (Appellant Brief, p. 42.) First, this statement is untrue. The First Paradigm Loan was secured by an interest in the Kings Hotel Loan, not the Kings Hotel Property, and the Second Paradigm Loan was used by NFSB to purchase the St. Augustine Property from AUG, a subsidiary of the Delaware Fund. Neither loan permitted a Net Five entity to borrow against equity in the real property. Second, Plaintiff focuses on what the Paradigm loan proceeds were used to pay, however the use of the proceeds is irrelevant to the analysis of whether Paradigm had knowledge of a scheme.

Nowhere in the FAC does Plaintiff describe how Paradigm loans, which were repaid, had any relevance to the alleged scheme. Conclusory statements that certain lenders ñplayed an integral role in furthering the fraudulent [scheme]ò is not enough when there are no allegations to support such a statement. Plaintiff tried to convince the Lower Court that all hard money lenders are suspect where

the borrower is unable to ñobtain financing from traditional banks and lending sources.ò (A. 1964, ¶ 154.) These are nothing more than naked assertions, devoid of further factual enhancement. *See Iqbal*, 556 U.S. at 663. In sum, not only has Plaintiff fails to allege that Paradigm had any intentional participation in the scheme, it fails to even allege plausibly how Paradigmôs loans supported the scheme.

D. Allegations as to Gerova, Not a Net Five Entity

Even if Paradigm had knowledge of the Gerova ñred flags,ò Plaintiff fails to allege that Paradigm could have known about the alleged involvement of NFH, NFKH, NFSB, or any of the alleged affiliated Net Five entitiesô (collectively, ñNet Fiveò). Many, if not all, of the allegations in the FAC that relate to Paradigm refer to Paradigmôs knowledge regarding Gerova and Gerovaôs involvement in the fraud, but make no mention of *any* Net Five entity. For example, the following allegations involve *only* Gerova: (a) Gerova failing to file financials (A. 1954, ¶ 129), (b) the delisting of Gerova (A. 1954, ¶ 130), (c) the resignation of Gerovaôs new CEO and Chairman (A. 1954, ¶ 131), (d) the articles regarding Gerova (A. 1954-56, ¶¶ 132-36), (e) the Dalrymple report about Gerova (A. 1956-57, ¶¶ 137-38), and (f) the class actions lawsuits against Gerova (A. 1957-59, ¶¶ 139-45). There is no mention of any Net Five entity with respect to any of these alleged ñred flags.ò Plaintiffôs only allegation as to a Net Five entity is with respect to the

injunction order entered on July 12, 2012, which was entered *after* Paradigm made both of the loans. (A. 1959, ¶¶ 146-47.)

E. Plaintiffôs Case Law is Distinguishable

Plaintiff relies on case law involving parties making loans to wrongdoers, *but also* having other significant involvement in the wrongdoersô scheme, as authority for a lenderôs liability in such scheme. These cases are distinguishable.

Plaintiff relies incorrectly on *Kottler v. Deutsche Bank AG*, 607 F. Supp. 2d 447 (S.D.N.Y. 2009). In *Kottler*, the plaintiff alleged that the defendants knew of the fraud and (a) ñintentionally took overt acts in furtherance of [the wrongdoerôs fraud] to sell faulty BLIPS tax schemes,ò (b) ñcreated false paper trails to minimize any appearance of involvement in the tax shelters,ò and (c) ñwas the developer of the BLIPS tax strategy.ò 607 F. Supp. 2d at 464-65. Similarly, in *In re Monahan Ford Corp. of Flushing*, 340 B.R. 1, 35 (Bankr. E.D.N.Y. 2006), the defendants participated directly in the scheme and there was no question that the defendants had actual knowledge of the scheme. For example, in *Monahan*, the complaint alleged ñthat [defendant] Ford, through its representatives . . . , and [defendant] FMCC, through its representative . . . , attended the meeting held in early 2001 where the scheme to defraud the debtor was hatched.ò *Monahan*, 340 B.R. at 33. Here, Plaintiff alleges only that Paradigm made loans and that it should have

known of the alleged scheme because of ñred flags.ò There is nothing here similar to the *Kottler* and *Monahan* cases.

Plaintiff also relies on *Minpeco, S.A. v. ContiCommodity Servs., Inc.*, 552 F. Supp. 327 (S.D.N.Y. 1982). In *Minpeco*, the plaintiff claimed the defendants conspired to monopolize the silver market and to artificially boost the price of silver, causing the plaintiff to lose over $80 million from its short position in silver futures. The defendant *brokers*, who ñlent money to the other defendants and provided them with trading assistance,ò moved to dismiss the conspiracy claims against them. *See Minpeco*, 552 F. Supp. at 330. In that case, the court denied the motion to dismiss because the plaintiff alleged *intent* to further the conspiracy. *See id.* at 331. But, in *Minpeco*, the defendants did more than just lend money to the wrongdoers, they were brokers who also provided trading assistance in a scheme that involved the manipulation of the price of silver that was traded on an exchange. *See id.* at 330. Here, Paradigm had no such involvement. Plaintiff has not alleged that Paradigm advised any wrongdoers with respect to the alleged fraud, nor has it alleged any intent on behalf of Paradigm. As the court stated in *Minpeco,* intent is required and the ñact of lending money to a conspirator does not cause one to be a co-conspirator.ò *Id.* at 330. Since Plaintiff fails to allege any involvement by Paradigm, other than as a lender, the FAC was correctly dismissed by the Lower Court.

F. Plaintiffôs Claims are Barred by the Doctrine of *In Pari Delicto*

As the Lower Court dismissed all of the common law claims, it did not rule on whether the doctrine of *in pari delicto* applies here. To the extent there are any common law claims, the claims are barred by the doctrine of *in pari delicto*.

Plaintiffôs entire argument in this proceeding is that the Funds were looted by Gerova and its principals through the so-called Gerova Transfer (where all of the Fundsô assets were transferred to Gerova). (Appellant Brief, p. 1.) Plaintiff then contends that after the Funds were left empty shells, Gerova transferred those assets to Net Five to keep the assets away from the Fundsô creditors. In sum, this entire case is about the fraudulent conduct by Gerova and its principals and, to a lesser extent, the Funds and Net Five.

Plaintiffôs common law claims for conspiracy to defraud and convert, aiding and abetting conversion, and aiding and abetting breach of fiduciary duty were assigned to it by those same wrongdoers. The doctrine of *in pari delicto* bars these common law claims as it denies any such relief to the wrongdoers (here, Gerova, the Funds, and Net Five). *See, e.g., MF Global Holdings Ltd. v. PricewaterhouseCoopers LLP*, 57 F. Supp. 3d 206, 209 (S.D.N.Y. 2014) (doctrine of *in pari delicto* ñserves to deter illegality by denying relief to a wrongdoer and to avoid forcing courts to intercede in disputes between two wrongdoersò); *Kirschner*

v. KPMG LLP, 15 N.Y.3d 446, 464 (2010) (ñdoctrine of *in pari delicto* mandates that the courts will not intercede to resolve a dispute between two wrongdoersò).

Here, Plaintiff, as the assignee of Gerova and the Fundsô claims (A. 1927-38, ¶¶ 21-22), is a participant in the alleged unlawful activity that forms the basis of this adversary proceeding. Further, the doctrine of *in pari delicto* should apply, even at the pleading stage of this case. *See, e.g., Picard v. JPMorgan Chase & Co. (In re Bernard L. Madoff Inv. Sec. LLC)*, 721 F.3d 54, 65 (2d Cir. 2013) (analyzing *in pari delicto* and stating that ñ[e]arly resolution is appropriate where . . . the outcome is plain on the face of the pleadingsò). Lastly, the doctrine applies to trustees or others that stand in the shoes of others (*i.e.,* Plaintiff). *See, e.g., Picard*, 721 F.3d at 64 (ñPicard [the trustee] stands in the shoes of BLMIS and may not assert claims against third parties for participating in a fraud that BLMIS orchestratedò).

G. Plaintiff has no Standing to Assert Common Law Claims

Since Plaintiffôs fraudulent transfer claims against Paradigm must be dismissed under Section 544 (as discussed in Point I and Point II above), Plaintiff does not have standing to assert only state common law claims against Paradigm because the Bankruptcy Court has no jurisdiction over those claims. In other

words, without claims under Section 544, all that remains are state law claims of a non-debtor against another non-debtor.

These remaining claims are not proper in the Bankruptcy Court as it does not have jurisdiction over the adversary proceeding absent Section 544 claims. *See, e.g., In re Residential Capital, LLC,* 527 B.R. 865, 871 (S.D.N.Y. 2014) (noting the different tests used by courts, but using the ñclose nexusò test that analyzes whether the action has ña close nexus to the bankruptcy plan or proceedingò for the court to exercise jurisdiction). Here, besides the Debtorôs creditors potentially receiving a portion of any litigation proceeds, the action against Paradigm has no effect on the bankruptcy case. *See, e.g., General Media,* 335 B.R. at 75-77 (bankruptcy court cannot hear a post-confirmation dispute simply because it might conceivably increase the recovery to creditors, because the rationale could ñendlessly stretch a bankruptcy courtôs jurisdictionò; the turnover claim ñis the most jurisdictionally far-fetched . . . as the [property at issue] was never property of [the debtor] or [the debtorôs] estate . . . [i]nstead, the plaintiff acquired its rights, by assignmentò) (citations omitted). It is not the Debtorôs claims or property being prosecuted against Paradigm, it is alleged assets of non-debtor third parties. These claims should be dismissed.

POINT VI

PLAINTIFFôS UNJUST ENRICHMENT AND CONSTRUCTIVE TRUST CLAIMS FAIL[13]

A. Unjust Enrichment

To state a claim for unjust enrichment the plaintiff must show that, among other things, that the defendant was enriched. *See Mandarin Trading Ltd. v. Wildenstein*, 16 N.Y.3d 173, 182 (2011). Plaintiff states that each defendant ñreceived the benefit of Real Property Interests that were stolen from the Funds, but paid the Funds nothing.ò (Appellant Brief, p. 48.) As against Paradigm, however, Plaintiff allegation is simply illogical. Paradigm made two loans. It was *repaid* on those loans. Plaintiff fails to allege how Paradigm was enriched, let alone how any enrichment was unjust.

For this reason and the other reasons set forth in the Decision, Plaintiffôs unjust enrichment claim fails.

B. Constructive Trust

Plaintiff argues that constructive trust applies because the defendants committed fraud. (Appellant Brief, p. 49.) However, the FAC does not adequately

[13] These claims also fail for the same reasons set forth in Point V.F and Point V.G above.

allege any fraud against Paradigm. Plaintiffôs unfounded statement that Paradigm ñbenefitted from and helped further the Schemeò (Appellant Brief, p. 49) has no support whatsoever. Paradigm made secured loans to NFKH and NFSB, the loans were repaid, and the security released. The issue ends there.[14]

CONCLUSION

For the foregoing reasons, the Order and Judgment should be affirmed.

Dated: February 17, 2017

Respectfully submitted,

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[14] Plaintiffôs accounting claim against Paradigm was dismissed. (A. 2289; Decision, p. 103.) Plaintiff does not include this claim in its appeal.

CERTIFICATE PURSUANT TO RULE 8015 OF THE
FEDERAL RULES OF BANKRUPTCY PROCEDURE

The foregoing brief complies with the type-volume limitations of Rule 8015(a)(7)(B) of the Federal Rules of Bankruptcy Procedure because it contains 6,737 words, excluding the part of the brief exempted by Rule 8015.

/s/ Brian J. Grieco

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 7.1 of the Federal Rules of Civil Procedure, defendant appellee Paradigm Credit Corp., by and through its undersigned counsel, states that no company owns 10% or more in Paradigm Credit Corp.

McLAUGHLIN & STERN, LLP

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